Objectives
This module will focus on the softer but very important elements of commercial ag lending. The learning objectives are to:

- Introduce individuals to the win-win negotiation process that meets the needs of both borrower and lender for a sustainable lifetime relationship.
- Discuss the elements of leverage and strategy used in the negotiating process with examples and applications from business development and financially stressed situations.
- Discuss guidelines for writing loan narratives and tools for effective communication and documentation of loan decisions.
- Introduce and explain the role of ethics, core values and social responsibility from an lender, customer and business perspective.
Introduction
In today’s competitive agricultural environment, good negotiation skills are becoming critical. Lenders indicate that business is becoming more price sensitive particularly with large commercial customers. Some of the latest research has suggested that large growth oriented customers will seek another lender for as little as 50 basis points difference in interest rate.

In a competitive world, your ability to develop negotiation strategies that are beneficial to the lifetime customer relationship and income stream of earnings to an institution is critical. The ability to communicate in a clear, concise manner is becoming more evident. Individuals at many different levels can scrutinize files and communications, thus written narratives are important in providing historical markers and documentation of analysis and discussions that have transpired. Intense competition in the field of agriculture and rural areas can test the ethics and value systems of the institution, individual and ag lender support teams.

Negotiations
In times past an ag lender’s job was simpler and more defined. In today’s environment, an effective ag lender has a much broader range of responsibilities and challenges. For lenders to be effective, they must be able to negotiate solutions for the benefit of the institution and the borrower.

Negotiations are defined as “the action of conferring with another so as to arrive at the settlement of some matter agreeably”. When a loan officer negotiates all efforts are made to reach a settlement agreeably while meeting the needs of the institution.

The ability to successfully negotiate is a critical skill needed in the management of performing as well as distressed credits. Negotiation leads to a mutually rewarding outcome between the borrower and financial institution.

A loan officer can begin by recognizing that there are certain skills, styles, and techniques to be used. Most successful negotiations involve a great deal of preparation which can be divided into three stages:

- **Analysis:** Diagnose the situation; gather information through interviews, review of financials, and lien searches; organize the information, facts and statements; and critically think through the issues.

- **Planning:** Generate ideas; discuss your thoughts and perspectives with your associates or supervisor; Gain approval for identified action; list alternative options and limits; decide your course of action and possible outcomes; sometimes role playing through a call plan is helpful in difficult situations.

- **Discussion:** This is the actual negotiation table where options are presented, common ground is sought out, obstacles and objections are discussed, and
solutions are developed for a mutual benefit. Agreement, timelines and execution strategy is agreed upon.

In preparing, the loan officer can formulate a negotiation strategy. The preparation of that strategy is a critical element in formulating a master plan for successful negotiation.

For example, if you are dealing with a financially distressed dairy situation then you should prepare accordingly. Get an updated lien search. Obtain the latest financials. Observe milk production trends, dairy assignment totals, and net milk check averages. Contact the feed and fertilizer supplier to see if accounts payable are getting out of hand. Visit with other key suppliers and service people who have past due accounts and see what their collection plans are. Of course, prior to contacting any vendors the lender should have the appropriate release forms signed by the prospect or customer that give permission to do so. After you gather the above information, organize the information along with financial statements and loan structuring alternatives. With this information you can plan by generating ideas, establishing options and deciding on a course of action in the discussion stage.

You are now across the table from the customer in the discussion stage of negotiating. To obtain optimum results from the negotiation it would help to control three key elements:

- Information
- Time
- Climate

The party with the most information about the other's situation has more control and power. The party who has the most time has better control. If you use your time effectively, you can be persistent. Of course there are always time constraints and they should be taken into consideration. Climate deals with integrity, trust, and openness. If you control the climate by demonstrating those traits, you will have an advantage in overcoming some of the borrower's objections. Use information, time and climate to formulate the master plan.

The ability to negotiate on a problem account, or competitive new business client is critical if you are to be an effective agricultural lender. Like other disciplines, knowledge and skills are needed to be successful. Of all these skills, preparation is the most important. Without being adequately prepared, you are doing yourself, the financial institution you work for, and the customer a disservice. Good preparation sets the stage in formulating strategies. A well thought out strategy puts you in control and maximizes your potential.

**Win-Win Strategy**

Generally there are three basic outcomes that can result in dealing with differences between individuals. One is the “win-lose” outcome. This is where one of the parties is the winner at the expense of the other. You might think this is a good outcome if you are the winner; however, this situation is not conducive to long-term relationships.
In “lose-lose” outcomes, neither party comes away feeling their needs have been satisfied. These outcomes result when the parties are concentrating on the means (my way or your way) rather than the end or ultimate objective.

The third outcome, “win-win,” focuses on the ends or goals rather than the means. It involves reaching an agreement that achieves both parties’ goals and is acceptable to everyone involved. By definition, a win-win agreement is one in which the interests of both the organization and customer are served.

In lending negotiations, it is important to use a win-win approach whenever possible because lending, particularly to commercial customers, is relationship rather than transaction-oriented.

A credit officer must be sensitive to the ongoing effect of any negotiated agreement. By using a win-win strategy, a credit officer can avoid attacking the customer’s position; instead, the credit officer examines the needs and interest behind the position. An attempt is made to find common ground by questioning, listening and clarifying; presenting new options; and explaining the organization’s needs. It’s often possible to find common ground when initial positions seem irreconcilable.

Successful use of a win-win strategy results in:

- Collaborative effort to search for mutual benefit and meet the needs of both sides.
- More frequent agreements that are acceptable to both sides
- Mutual confidence that can provide the basis for long-term relationships, despite one party having the negotiation leverage (i.e., time or power) where a win-win approach may not be needed. Balance and not giving into unreasonable demands and requests is a key.
- Success is more likely if both parties are committed to the same end result.

The win-win concept illustrated in Exhibit 1 can be very useful in working through obstacles, objections and general interactions during the meeting.
Exhibit 1: Win-Win Negotiations

Both parties have a minimum and maximum structure in the negotiation process. The amount of flexibility between the customer’s and an institution’s minimum position determines the number and type of options and fall back positions. In the illustration, point “A” represents the lender’s minimum position. Any point to the left would be a win for the customer and a lose for the lender; the negotiations could break down. Likewise, point “B” represents the customer’s minimum position. Any point to the right would be win for the lender and a lose for the customer. Point “C” represents the negotiation range where options and ideas can be interchanged, which will not deter from either position. This whole illustrative process would be analogous to a person chopping wood with a wedge. If the point of the wedge goes past point “A”, the negotiations split off and likewise for point “B”. Thus, the whole idea of the win-win concept is keeping the wedge in between the boundaries of minimum position, otherwise known as the negotiation range.

The lender must prepare by knowing the limits of the institution’s policies before developing a starting point for the negotiations. The negotiation process involves “give” and “take” from both parties until a mutually beneficial agreement is made, so the lender should be prepared to “give” some to the customer to foster a positive result.

Negotiation Leverage
Negotiation is often based upon irrational factors, not interest rate alone. For example, the credibility of the loan officer or customer and reputation of the institution are examples of factors that could influence the situation over and above interest rates.

The element of leverage plays an important role in win-win negotiations. There are four basic elements of leverage:

- **Real power**: One side has the power, either real or perceived, to find or force a deal. For example, a producer may have limited options to finance because of financial conditions, giving the lender more power. To the contrary a producer who has many options because of strong financial conditions may have more
power than the lender. An institution may have the perceived reputation of aggressively seeking a loan in the good times and de-marketing loans in the down cycle. This, in turn, hinders their ability to seek business from strong clients, and weakens their real power position in the long run.

- **Personal power**: One side has the power because of some personal characteristic. For example, the loan officer has the authority to accept or deny the loan without checking with superiors. A producer is a nationally known breeder of livestock with an excellent financial reputation that local producers respect.

- **Knowledge or data**: One side knows more about the needs position than the other. For example, a lender has conducted a lien search and knows a balloon note on land purchase is up in 60 days without the option of continued owner financing. A producer doesn’t know that they will be dealing with a new loan officer because of a merger.

- **Time**: One side is under a time constraint or deadline. For example, a new hay baler loan needs approval today because the producer has a large amount of hay ready for harvest. The loan approval must be completed before interest rates increase next week is an example frequently observed in lending negotiations.

To summarize, all these points and perspectives must be considered in developing a suggested negotiation strategy.

- Determine the win-win strategy
- Determine the minimum positions (negotiation range) of each party
- Develop options and equivalent value to each party
- Establish common ground
- Compromise positions
- Concessions and fallback scenarios

**When Price is an Issue**

When an objection is based on price, an appropriate technique to use is to communicate the benefits the prospect will get at the price you have quoted. Establish benefits based on the prospect’s needs.

- **Add up** the benefits the prospect will receive at the price you have quoted, comparing their magnitude to the relatively small price difference. NOTE: Never quote price without first pointing out the benefits the prospect will receive. Avoid bringing up price early in a presentation.

- **Subtract** the benefits they want but will not receive at the lower price charged by competition. NOTE: When a competitor’s price is an issue, never talk about your price; instead, discuss the difference in price, not 8 percent versus 7 percent, but 100 basis points, or 1 percent. Be sure to use simple examples that are free of financial jargon that the customer can understand.
Divide your somewhat higher price differential by time, units, or a similar lowest common denominator, and compare to benefits received. For example is it worth 25 basis points to do business with a stable lender or loan officer? Is it worth 25 basis points to have a person that understands agriculture or your specific enterprise? In some cases you might find the competition better. Tip your hat to them and place yourself in second position in case the competition makes a mistake.

Multiply the opportunities available by what has been offered.

Finally, remember that business decisions are rarely made on price alone; they are made on the basis of value. This helps the customer arrive at a value-based decision based on logical business reasoning. It also demonstrates business professionalism, and gains respect from customers.

This strategy focuses the prospect’s attention on your company’s greatest strengths: the benefits built into your products and services and your ag lending team which provides greater value than the competition.

Negotiation Style

The term negotiation implies that there is some form of conflict that exists between the parties involved. Often each person comes to the negotiation table with conflicting needs, desires and objectives they want satisfied. The purpose of the negotiation process is to resolve the conflicts and reach an agreement that will mutually satisfy all parties.

People approach and deal with conflict in several different ways. Some withdraw from it as quickly as they can to avoid dealing with it. For example, you may have loan officers, customers, or employees who bring every “problem” they have to you for resolution. Have you ever run across the situation where a person is having trouble resolving your telephone request, so they put you on “hold” and never come back? This is another example of avoidance.

Others face conflict simply by “giving in” to whatever you want…”whatever you say is fine with me.” Somehow, you feel that the negotiation did not mutually satisfy needs.

Still other people approach conflict aggressively, intent on winning no matter what. Many of us may become intimidated by individuals such as these and give in to their demands, while others of us will simply refuse to deal with such people. You may often find this type of person when it is a seller’s market and you are told “you can take it or leave it.”

Conflicts occur for many reasons. They evolve around differences – differences in opinions, values, and objectives. There are five basic styles used when handling conflicts. These styles are:

- Collaborate
- Compete
CAL09 – Negotiations, Loan Narratives & Business Ethics

- Compromise
- Accommodate
- Withdraw

Each person’s situation is different and no one style can suit all the situations. It is important to adopt a style that is most compatible for you based on your strengths.

Prior to each producer visit, think about what you want to accomplish and how best to go about it. From prior experience you know what your customer is like, but be careful not to stress type of negotiation style. Keep your mind and options open.

Prepare for each visit. Discuss your options with your fellow workers and supervisors. Always negotiate with your company’s goals and objectives firmly in the back of your mind.

Finally, listen to your customer so you may identify his or her goals and objectives. Attempt to deal with his objectives en route to satisfying your needs. Now let’s quickly visit strategies you might want to utilize when dealing with the five basic styles, given keen business development competition or distressed credits.

Collaborate
- Works jointly with others
- Employs a problem solving approach
- Cooperates with all parties so needs of all parties can be reasonably satisfied
- Emphasis is placed on exploration of origination of conflicts
- Use the collaborative style for win-win outcomes. Also use when follow through is required and you want a continuing relationship.

Compete
- This is a forceful approach and usually leads to win-lose outcomes
- Tough, “non-negotiable” demands at the start
- Emotions, such as anger, are displayed frequently
- Few concessions are granted, if any
- May conceal bottom line
- Attempt to be competitive on one-shot deals

If you are dealing with a competitor you can do the following to keep from being the loser:
- Break up the conversation by asking “How do you feel about…”
- Never give the first concession
- Set your demands higher than you normally would
- Get used to saying “no” often
- Don’t be afraid to reach a deadlock and start again at some other place and time
Compromise
- Leads to no-win feelings because neither party is satisfied.
- Leads to second guessing
- All parties are more concerned with their needs
- Neither party is convinced of the values involved because they think about the concessions that have been given rather than received
- You compromise when continued dispute is more costly than agreement

Accommodate
- Leads to lose-win outcome
- ‘The nice person’ – Undervalues own worth and accomplishment
- Priority is placed on peaceful relations with others
- Strong tendency to sympathize
- Tend to have a ‘don’t rock the boat’ philosophy
- Tend to be accommodating when stakes are low
- May want to accommodate in order to deposit some good will

Withdraw
- Leads to lose-lose outcomes because no decision is reached
- No commitment to problem solving
- Behaviorally impersonal
- Withdraw when the rules change or under stress
- Sometimes this style can be prudent if the competitor has priced an obvious loss.

In the art of negotiations, preparation, execution and follow thru are essential. However one must be adaptive and customize based upon situations and styles.

Loan Narratives: Documenting and Communicating the Loan Decision
The results of the credit analysis should be compiled in a single document that fully describes the issues considered by the loan officer as a basis for approval or rejection of the loan. This document is called a loan narrative, although credit report, credit analysis summary, loan comment sheet, or credit memorandum are other commonly used titles.

The loan narrative becomes a valuable resource for communication between various parties involved in the lending process, such as loan committees, credit managers and credit reviewers. It also provides an important historical reference in the credit file that can be accessed in subsequent years to interpret previous lending experiences and levels with the borrower.

Once a decision is made, either to approve or reject a request, the lender should inform the borrower of this decision in a timely and professional manner. The decision should always be conveyed in writing in order to avoid confusion later. The loan officer needs to know what elements should be conveyed in such communication. The lender should
also be aware of the process of appeal that should be followed by an applicant who wishes to seek reconsideration when an adverse action is received.

**Basic Elements and Uses of the Loan Narrative**
The loan narrative has several basic elements or purposes:
1. It should capture the significant conclusions the analyst has reached about each of the credit factors.
2. It should highlight the applicant’s strengths and weaknesses.
3. Where weaknesses exist, it should explain the problems, causes, and possible corrective actions.
4. It should clearly document the ultimate recommendation for loan approval or loan rejection.
5. In some cases, it should outline a specific plan for loan servicing by the lender.

**Contents of Loan Narratives**
Loan narratives generally cover most or all of the following topics:
1. Individual/entity
2. Property, plant and equipment
3. Financial position and progress
4. Repayment capacity
5. Security
6. Loan purpose
7. Summary of strengths and weaknesses
8. Current or proposed risk classification
9. Loan structure and pricing
10. Loan recommendation
11. Loan servicing plan

An outline or checklist can sometimes serve as a helpful reminder of key credit and financial topics that should be addressed. Appendix A consists of a detailed topical outline that can be used as a reference guide when making a credit decision and documenting the basis for that decision.

**Writing the Loan Narrative – Format, Length and Style**
Loan narratives have no set format or length. Some lenders prefer a pre-designed worksheet that addresses the major subject areas and leaves comment space for each factor. Other lenders prefer a blank “comment sheet” leaving the structure of the report to the loan officer.

Guidelines for preparing the loan narrative include:
1. Comments should be concise and analytical. Rather than restating raw data contained in other loan documents, comments should refer to and draw conclusions about the data.
2. The detail should be greater on a new applicant than a longstanding applicant with good credit history. For the latter, loan narrative comments might consist of a
brief sentence: “Fifth loan to long-established borrower; all credit factors remain favorable; recommend approval with no special conditions.”

3. The degree of detail should escalate as the size, complexity and risk of the loan increase. A $2,000,000 loan warrants much more effort in documentation and analysis than a $10,000 loan.

4. Each loan narrative should highlight the features unique to that particular loan situation. Written reports should not appear as a “cookbook” where one simply follows a standard outline, writing a set amount of prose on every topic. Instead elements that are most relevant in describing the creditworthiness of that particular applicant should be addressed in greater detail.

**Communicating the Credit Decision**

Each applicant has a right to a fair and timely decision concerning his or her credit request.

**Loans that are Approved**

The approval decision is usually conveyed orally and then followed with a written confirmation. The commitment document should convey:

1. The standard elements of the loan:
   - Amount approved
   - Term (or maturity)
   - Interest rate
   - Stock investment requirement, if a cooperative
   - Security to be taken
2. Specific requirements to be met prior to loan closing.
3. Special conditions, covenants, or requirements that must be adhered to once the loan is closed.
4. Special financial disclosures – i.e., Truth-in-Lending, Equal Credit Opportunity Act regulations, and any other disclosures that must be made to the borrower.

Once all pre-closing conditions are met, the loan is ready to be closed and disbursed.

**Loans that are Rejected**

These loans fall into two categories:

1. Loans that cannot be made under any circumstances
2. Loans that could be made if specific corrective actions occurred

All applicants are entitled to a written notification of loan rejection and the reason for the credit denial. Those whose loan might be reconsidered if certain changes are made should be so informed.

The loan rejection should be handled in a fair, tactful and effective manner. Reasons for the rejection should be clearly stated. Do not place the “blame” for a loan rejection on a
loan committee. Proper and tactful handling of the loan rejection will also help discourage needless appeals of the credit decision.

**Summary**
Documenting one's credit analysis in a formal loan narrative is an important facet of the loan making process. This narrative documents the rationale that supported the ultimate decision to approve or reject the loan.

Applicants have a right to appeal a decision. Appeals, while seldom used, should be steered quickly through proper channels. In so doing, the lender can avoid unnecessary parties becoming involved in resolving the conflict.

**Business Ethics**
Ethics is the moral code by which we live and conduct business or the concept of right and wrong. Ethics is derived from the cultural, social, political and ethnic norms by which we were raised as children. People seldom ponder their value system, but act instinctively on the basis of it.

Harvard Business School conducted a survey of its alumni to find out what it needed to teach its future business leaders. The response most cited, above technology, globalization and leadership, was morals and ethics.

Many people believe if they follow the Golden Rule (Do unto others as you would have them do unto you) they are safe from ethical dilemmas. Unfortunately, most ethical dilemmas in the business, economic and financial world are “gray areas” that are troubling when one attempts to apply the ethical principle.

**Ethical Myths**
Many feel that business ethics is new and is only for philosophers, academics and theologians. Some consider it a passing fad, with no practical relevance and that ethics can’t be managed.

Business ethics is a management discipline. It involves working through confusing and stressful dilemmas. Usually, there are few easy and simplistic solutions. One can be unethical and still operate within the law. While the law serves as a guide, it should not be considered the absolute limit for institutional and personal behavior.

**Ethics in decline**
A recent study of Iowa farms found some intriguing results. Nearly 90 percent felt that ethical standards of the general population had declined and over half stated that ethical standards of farmers had declined.

Over 90 percent stated that you must obtain agreements in writing rather than a trust a person’s word. A large share felt that ethical standards had declined because of the loss of respect for authority.
Developing a Code of Ethics
The process of developing a code of ethics begins with an individual or company conducting self-examination to identify values held by the individual or company. It is about prioritizing moral values for the workplace and ensuring behaviors are aligned with those values.

The following is a list of ethical values that should be considered in a code of ethics:

- Trustworthiness: loyalty, honesty, integrity
- Respect: privacy, dignity, courtesy
- Responsibility: accountability, pursuit of excellence
- Caring: compassion, kindness, giving, consideration
- Justice and fairness: objectivity, impartiality, consistency, equality
- Civic virtue and citizenship: abiding by the law, community & public service, protection of the environment

A code of ethics should outline behaviors the business or individual should display. Answering the following can assist one in any ethical decision.

- Identify key behaviors necessary to adhere to ethical values in your code of ethics
- What actions taken result in the greatest good for the partners involved?
- Will the actions respect the rights of all parties?
- Are the actions just? Who will be hurt by the actions?
- Would I be proud of the actions if they were announced in the local newspaper, on television, or on the Internet?

The code should address behaviors specific to the company and it should be fluid and dynamic given a changing environment.

Ethics in Stressed Situations
There will always be people who are willing to risk reputation and livelihood through unethical behavior. In stressed situations these conditions can escalate. It’s easy to be ethical when things are going well, but when conditions are unfavorable, there is more chance ethics may be compromised. For example, a producer facing financial stress who can’t meet payroll or a loan officer who needs one more loan before the end of the month to meet goals that leads to a large bonus can cause pressure to act unethically. Again the importance of sticking to an ethical code is critical because out of today’s desperation or personal agenda the results can follow you for the rest of your life.

Ethical Culture Characteristics
Organizations with high integrity exhibit a clear vision of integrity throughout the organization. It is owned and embodied from the top down. Reward systems are aligned with policies and practices, and everyone understands that decisions have an ethical dimension.
These organizations are obsessed with fairness and accountability. Responsibility starts with the individual and filters to the team and organization. Activities related to ethics have terms of purpose.

A code of conduct must be clear and understandable. Yes, this includes policies and procedures that support everyday business activities. Don’t just take the three P’s approach: Print it, post it, and pray they read it. Instead the code must be discussed with suggested changes.

Leaders must demonstrate and communicate expected ethical attitudes and behaviors. These include regular programs in place to support and enhance the ethical culture. In some companies, ethical behavior by the lender has become legendary and part of the company culture that people speak about with pride over and over again.

Clear and accessible ways for people to confidentially report alleged violations of code, policies and acts of misconduct should be available.

Employees, suppliers and customers should abide by the code and be aware of the consequences of improper action. To keep the ethical environment dynamic, a review of formal and informal standards and factors to undermine the ethical culture needs to be conducted periodically.

Learning activities must be in place that support and update the ethical climate. Employees should be educated about ethics through workshops and by hypothetical situations. For example, what would you do if you found out an employee was spreading confidential information to the public? Positive personnel practices should encourage employees to contribute spontaneous efforts behind ethics and goodwill.

**What About Me?**

Many of you are probably asking, how does this apply to me regardless of my responsibility in the organization? Ethical tools and code of conduct can be far reaching: the style of dress; use of computer for personal gains; accepting gifts; receiving under the table perks from brokers and appraisers; maintaining confidentially of financial and personal information. Avoiding racial and sexual discrimination, conflicts of interest, and reporting of illegal and questionable actions can be linked to the individual.

**Walk the Talk**

Some people talk the talk; others walk the talk. How you treat and deal with your co-workers, customers, alliances, and prospects are real life demonstrations of ethics. It’s how we behave when no one is watching both in the work and personal life environment. When in doubt, err on the conservative side. As a wise, experienced dairy farmer once stated “you only get one chance at a favorable first impression, but you are only as good as your last impression”.

Commercial Ag Lending

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Appendix A: Outline of a Loan Narrative

A. Proper title
   1. Date and name of person preparing narrative

B. Eligibility
   1. Who is (are) applicant(s)?
   2. What is the legal structure of the borrowing entity?
   3. Is applicant eligible for credit?

C. Character (honesty, integrity, moral character, standing in community, and cooperation)
   1. Production management
      a. Are modern methods used?
      b. Is work done on time?
      c. How do production results compare with peers (proven yields versus FSA county averages)
   2. Marketing
      a. Is marketing plan developed annually?
      b. Is production marketed on an orderly basis, or held excessively long to speculate on outcome?
      c. Are prices received respectable based on pricing opportunities available during the marketing year?
   3. Financial management
      a. Is a good records system in place?
      b. Is insurance coverage adequate?
      c. Are estate plans, wills, etc. in order?
      d. Are cash flow budgets prepared, monitored and adhered to?
      e. Does borrower comply with loan commitments, using funds as intended and repaying as agreed?
   4. Personnel
      a. Are employees handled professionally?
      b. Where multiple parties are involved
         i. Are responsibilities clearly divided and is accountability for major decision making fixed among operators?
         ii. Is there a spirit of cooperation, coordination and mutual respect among principals?
         iii. Are operating arrangements between principals properly documented (i.e., articles of incorporation, bylaws, and partnership agreements)?

D. Management ability
   1. Production management
      a. Are modern methods used?
      b. Is work done on time?
      c. How do production results compare with peers (proven yields versus FSA county averages)
   2. Marketing
      a. Is marketing plan developed annually?
      b. Is production marketed on an orderly basis, or held excessively long to speculate on outcome?
      c. Are prices received respectable based on pricing opportunities available during the marketing year?
   3. Financial management
      a. Is a good records system in place?
      b. Is insurance coverage adequate?
      c. Are estate plans, wills, etc. in order?
      d. Are cash flow budgets prepared, monitored and adhered to?
      e. Does borrower comply with loan commitments, using funds as intended and repaying as agreed?

E. Property, plant and equipment
   1. Comment on the size and nature of operation; anticipated changes
   2. Stocking capacity and present stocking ratio – is unit fully stocked?
   3. Condition of equipment line and improvements. What major capital improvements and machinery updating will be required in the next 1-5 years?
   4. Highlight evaluations based on on-farm field inspection

F. Financial position and progress
   1. Comments addressing this credit factor should answer three questions:
      a. What is the current financial position?
      b. How was it attained (i.e. earnings, inflation, inheritance)?
      c. What are projections for future? Are they realistic?
   2. Factors that should be addressed include:
      a. Cash flow
      b. Liquidity (working capital)
      c. Solvency (leverage ratio; growth in net worth)
      d. Profitability
      e. Financial efficiency and activity
      f. Production efficiency/performance
         i. Calf crop percentage, weaning weights, etc.
         ii. Crop yields
      g. Budgeting – projections versus actual performance

G. Repayment capacity
   1. Discuss debt service requirements in relation to debt service capacity.
   2. Are repayment margins adequate?
   3. Are projections reasonable based on past loan performance?
   4. Where outside income is essential for living and debt service
      a. Is job situation relatively tenured?
      b. Has salary-wage estimate been verified with employer?

H. Security
   1. What is the risk level on this loan?
   2. How much security is needed? Is adequate security offered (loan/appraised value ratio)?
   3. Comment on security quality. Is it destructible? Should insurance be required?
   4. What security interests are held by other creditors; how do they affect lien positions we have or plan to implement?

I. Loan purpose
   1. Is loan purpose constructive?
   2. Based on applicant’s structure, agricultural involvement, and requested use of funds, can the institution loan funds?

J. Summary (highlight major strengths and weaknesses of applicant)

K. Loan recommendation
   1. Amount to be approved
   2. Purpose for which funds can be used
   3. Disbursement plan
   4. Term (maturity)
   5. Repayment plan
   6. Security to be taken
   7. Special conditions to be enforced

L. Loan servicing plan
   1. Description of loan officer’s plan for loan servicing over and above normal servicing (particularly important on problem accounts). Items to address could include:
      a. Financial reports to be obtained and monitored
      b. Plans for conducting on-site field inspections
      c. Periodic cash flow monitoring and loan status analyses to be done (i.e., quarterly) and reported to credit manager, etc.
      d. Tickler files to be set up for follow-up on repayment plans
      e. Special actions or plans to be taken to collect a problem account or strengthen the loan position during the loan period
1. Are loan narratives written only to please credit examiners?

No. The reason for compiling a comprehensive, detailed loan narrative is not merely to appease a credit examiner. The loan narrative benefits the lending institution.

- It enables a consistent use of the credit analysis process with every loan application.
- The loan narrative informs all personnel who will be involved in the decision, from the lender and loan committee to examiners. Sometimes due to size of the loan or degree of risk involved, alliances or central institutional review teams may be involved.
- The loan narrative provides continuity of the communication between the lender and borrower. Loan officers periodically are promoted, reassigned to new borrowers, resign, or retire. Well-documented credit files provide continuity from one loan officer to the next.
- The quality of the narrative is an excellent indication of the loan officer’s ability to properly collect and analyze credit data, and to formulate a sound credit recommendation.

2. Your Pop Quiz: We will begin this section with a quick quiz pertaining to selecting a world leader. It is time to elect a new world leader, and your vote counts. Here are the facts about the three leading candidates:
   a. Candidate A: Associates with crooked politicians, and consults with astrologists. He’s had two mistresses. He also chain smokes and drinks 8 to 10 martinis a day.
   b. Candidate B: He was kicked out of office twice, sleeps until noon, used opium in college and drinks a quart of whiskey every evening.
   c. Candidate C: He is a decorated war hero. He’s vegetarian, doesn’t smoke, drinks an occasional beer and has had no extramarital affairs.

   Which of these candidates would be your choice?

If you selected Candidate C, you just elected Adolph Hitler. A and B are Franklin Roosevelt and Winston Churchill, respectively.

Don’t feel bad if you elected the bad guy. I did too. This provides us with a backdrop to the all-important topic of ethics and the code of conduct.

3. Could you give us some examples of ethics in decline?

During the 1990s, one of the top investment analysts at Merrill Lynch touted several internet stocks. According to the Attorney General of New York, Merrill Lynch intentionally misled investors in order to gain the lucrative investment banking business from its clients.
Enron was one of the biggest success stories in American business history. This company literally came from nowhere to dominate the energy trading market by mid-year 2000. On the lists of America’s Most Admired Companies, Enron rated second for “Quality of Management.” Despite all of this, Enron collapsed in a titanic heap that is still smoldering.

How did this happen?
Enron failed because at its very core it did not make integrity a fundamental value of business. Because of this, trust was lost. Once this happened, it could not be regained.

4. Dr. Kohl, tell us about an ethical dilemma you’ve witnessed.

One of the weeklong lending schools I was lecturing at had a farmer/rancher panel. A co-instructor, who is a banker, selected three panelists to participate. One panelist was one of his prime customers. A banker student enrolled in the class attempted to hard sell all the members of the panel after their session during the social reception. This ethical foul-up really placed many bankers attending the school in a sour mood, and hindered our ability to get bankers to volunteer names for following years’ panels.

5. Can you give us a positive twist on ethics?

A father and son were in the dairy business. Dad allowed his son to take over the financial record keeping that had been done by Mom. The son got “bigness on the brain” and “paint fever,” which resulted in a machinery, technology and equipment run up of over 25 open accounts ranging from $500 to $25,000. When confronted by the lender and his father, the son left the business with the debt in a New York minute! However over the next five years the father worked extra construction jobs along with the farm work and paid off every account and lender. Now that’s good old-fashioned agricultural character.

6. What do you feel are the keys to effective negotiations?

Preparation, preparation, preparation! Planning and analysis are the keys. Developing a call plan, brainstorming ideas, being able to establish options and limits, an action and execution plan is critical. Having a secondary fall back position can be a useful strategy and of course an exit plan is important as well.

7. Can stressed credits or pressured marketing targets impact ethics?

Yes, when people are placed into adverse situations, ethics can be challenged. For example, cattle can disappear over the mountain or the neighbor’s cattle are brought in when the lender is conducting an inspection. Some lenders and appraisers have joined together to conduct bogus appraisals with payoffs and kickbacks because of extremely competitive situations.
8. What are the biggest mistakes made in writing loan narratives?

Too much verbiage and too many numbers with infinite detail and misspelled words are commonly seen. Most loan narratives are one page or less, with numbers in an appendix. It seems that spell check has only made many professionals lazy in reviewing narratives and determining whether the document makes sense. Few proofread their work and loan narratives become too cookie-cutter in approach. You need to customize.

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*Information on Loan Narratives was adapted from “Documenting and Communicating the Loan Decision” in Constructive Agricultural Lending: Farm Credit Applications Reference Guide, 1984.